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C O N F I D E N T I A L BUENOS AIRES 001653

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TAGS: EINV ECON EFIN BEXP AR
SUBJECT: ARGENTINA: GOA CHARGES AES AFFILIATE WITH
ACCOUNTING MANIPULATION, UNDERINVESTMENT

REF: '07 BUENOS AIRES 1352

Classified By: CdA T. Kelly. Reasons 1.4 (B,D)

Summary

¶1. (C) Argentine Planning Minister De Vido convoked Ambassador December 2 to inform him that that the GoA plans to take civil and criminal action against AES Corporation for tax evasion and intentional decapitalization of its Edelap electricity distribution subsidiary. De Vido emphasized that this legal action against AES is a stand-alone case that did not in any way reflect a GoA bias against U.S. companies or investment. De Vido has summoned senior AES management from the United States to answer GoA concerns. Separately, the GoA has issued a series of official news agency releases charging that an audit of Edelap has uncovered "grave accounting irregularities" involving the transfer of Edelap debt to tax-advantaged Uruguayan AES affiliates, keeping Edelap indebted to the extent that it has been unable to fund capital investment needed to maintain service quality to its 300,000-strong client base. Local energy analysts call De Vido's action the latest in a series of GoA efforts to encourage AES to sell down its Edelap affiliate to crony capital interests linked to the Kirchner administration at a price far below market value. AES management notes GoA controls on electricity tariffs have kept Edelap operating at substantial losses since the 2001/2 economic crisis. They categorically deny GoA charges and argue that the firm's purchase of Edelap debt was intended to conserve Edelap cash reserves for needed capital expenditures. The GoA move comes in the immediate aftermath of four days of heat wave-induced power outages in the Greater Buenos Aries metropolitan area, including by Edelap, that are said to have personally embarrassed Minister de Vido. End Summary.

Ambassador Summoned by Planning Minister

¶2. (SBU) On the evening of December 2, Ambassador met with Planning Minister De Vido at the Minister's request to be notified that GoA electricity regulator Ente Nacional Regulador de la Electricidad (ENRE) would take legal action against AES Corporation for the alleged tax evasion of its Edelap subsidiary. Edelap is an electricity distribution company serving some 300,000 clients in the La Plata, Buenos Aires province region. Also attending the meeting were Planning Ministry Undersecretary for Coordination and Control Roberto Baratta, Undersecretary for Legal Affairs Rafael Llorens, EconCouns, and Press Attache.

GoA Announces Legal Action Against AES

¶3. (SBU) The Ambassador's summoning had been previewed in a Telam (official news agency) release November 30 that noted irregularities found in an ENRE audit of Edelap that raised suspicions of "vaciamiento" (an intentional hollowing-out or decapitalization of the firm by its owners). Immediately following the meeting, the Planning Ministry issued a press statement, picked up by all major dailies, that an ENRE audit of Edelap had uncovered "grave irregularities," highlighting allegedly questionable accounting that benefited Edelap parent AES while "provoking a significant deterioration in the economic/financial condition" of Edelap. The release linked the irregular accounting to AES's purchase of Edelap debt to commercial banks under "beneficial conditions" (i.e., at a discount) while maintaining these Edelap obligations on AES books at full face value. In so doing, the release charged, AES effectively transferred Edelap's profitability to other AES group companies, including AES affiliate Luz de La Plata SA, which also benefited by charging Edelap exorbitant management fees. As a result of such accounting manipulation, the release charged, AES has kept Edelap indebted to the extent that it has been unable to meet capital investment levels needed to maintain service quality to its 300,000-strong client base. The release concluded that both the Planning Ministry and ENRE are evaluating civil and criminal "corrective actions."

¶4. (C) In the December 2 meeting, De Vido outlined this release information to the Ambassador. The Minister noted

that, had Edelap not been in such poor financial and operating conditions, such an audit probably would not have been undertaken. De Vido said that an Uruguayan AES special purpose entity, AES Platense Investments Uruguay SCA, had purchased non-performing Edelap debt held by Bank Boston (currently Standard Bank) and Banco Galicia at a substantial discount from face. He highlighted suspected AES tax evasion via this "tax-advantaged" Uruguayan entity, calling this a very serious legal issue that merited judicial review. Finally, De Vido passed Ambassador copies of ENRE audit documents highlighting that AES had purchased a total of ARP 76.8 million (US$ 22.6 million) in Edelap debt to Bank Boston and Banco Galicia for a discounted value of 52.7 ARP million (US$ 15.5 million). The document also showed that one of the AES affiliates that owns a share of Edelap, Luz de La Plata SA, had booked some ARP 19 million (US $ 5.6 million) in management fees over the 2001-7 period, which Undersecretary Baratta called "excessive." Overall, the documents showed inter-group transfers totaling ARP 55.3 million. Baratta also question Edelap management's competence, charging that Edelap last year had fired some of its best technical people without cause.

AES' Side of the Story

¶5. (SBU) AES Argentina's top managers, President Eduardo Dutrey and External Relations Director Guellermo Baistrochi, had contacted EconCouns following the initial November 30 Telam news agency release. Embassy has advocated extensively on behalf of AES since 2006, including with the federal Planning Ministry Secretary of Energy over late payments to AES power generation plants, and with Province of Buenos Aires authorities in 2007 to facilitate regulatory approval of the sale of another AES electricity distribution subsidiary in Buenos Aires province to Ashmore Energy International.

¶6. (C) Post contacts in the energy sector call this GoA action the latest in a series of GoA efforts to encourage AES to sell down its Edelap affiliate to "designated crony capital interests of the Kirchner administration" at a price far below market value. They note as a case in point the 2004 sale by Electricite de France of its far larger Buenos

Aires metropolitan area electricity distributor Edenor at a fraction of its market value to a local firm, Pampa Holdings (owned by local entrepreneur and Kirchner friend Marcelo Mindlin). Post energy sector contacts believe that Cordoba-based Electro Ingeneria (EI) has been identified as the GoA's favored candidate to purchase Edelap. EI principal Gerardo Luis Ferreyra is an ex-Montonero guerilla who, during the 1976-82 military dictatorship, shared a cell with current Presidential Legal and Technical Secretary (and close confidant) Carlos Zanini. In early 2007, U.S. investment fund Eton Park's purchase of Petrobras' share in Argentine electricity transmission monopoly Transener was overturned by GoA regulatory authorities in favor of a joint venture bid between EI and GoA national energy company ENARSA (Reftel).

¶7. (C) AES Argentina officials explained that, following the GoA's "pesification" and freezing of public utility tariffs in the wake of the 2001/2 economic crisis, Edelap (along with virtually every other Argentine electricity distribution company) became insolvent and unable to service $26 million in U.S. dollar-denominated debt to Bank Boston and Banco Galicia. Like many of its peers, Edelap filed an ICSID international arbitration claim against the GoA. Edelap agreed to suspend (but not withdraw) the ICSID suit in exchange for an August 2005 GoA promise to permit a 28% increase in Edelap's electricity rates for rural industrial and commercial (but not politically sensitive residential) clients and to follow-on with a February 2006 full renegotiation of Edelap's rate base. While the 28% industrial user rate increase was eventually granted by the GoA to all major Buenos Aires province electricity distribution companies, the promised comprehensive rate base renegotiation has been repeatedly postponed. In September 2008, a second ad hoc 28% tariff increase was granted to Edelap and to two other federally regulated distribution companies.

¶8. (SBU) Notwithstanding allowed tariff increases totaling roughly 60% since 2002, AES notes that these rate increases have not kept pace with cumulative wholesale price index increases of over 200% during this period. As a consequence, AES says Edelap has been accumulating substantial losses, including 2005 losses of ARP 13 million on revenues of ARP 170 million, 2006 losses of ARP 7 million on revenues of ARP 180 million, 2007 losses of ARP 10 million on revenues of ARP 200 million, and projected 2008 losses of ARP 20 million on projected revenues of ARP 210 million.

¶9. (SBU) In discussions with EconCouns, AES Argentina management categorically denied GoA charges that it has wittingly decapitalized its Edelap subsidiary. They argued that AES's purchase of Edelap debt had just the opposite intention, to conserve Edelap cash reserves for capital expenditures. According to AES, Banco Galicia and Bank Boston debt had been refinanced and regularized in 2004 and in 2006 but in 2006/7, as Edelap's losses continued to mount, an AES financing subsidiary purchased and subordinated these bank loans; Edelap has paid neither principle nor interest to AES on these loans, averaging US$3.0 - $3.5 million per year, since they were purchased. AES also notes that Edelap has not declared a dividend in seven years in order to retain needed cash for investment.

Next Steps

¶10. (C) De Vido said that he had summoned two senior U.S. AES officials from AES Virginia headquarters -- Andres Vesey, President of AES's Latin America Division, and Bernardo DaSantos, Chief of Staff to Vesey -- to meet the evening of December 3. De Vido said that he had met Vesey, a Venezuelan national, earlier in New York. Local AES management will not be included in this meeting, De Vido said. (In a later aside, Undersecretary Baratta explained that the GOA had no confidence in local AES management.) De Vido promised that

his Planning Ministry would brief the Embassy afterwards. Ambassador agreed that discussions with AES senior management were worthwhile in light of concerns raised by the ENRE audit and noted that our interest would be that the company be treated fairly.

No GoA Problems with Other U.S. Investors

¶11. (SBU) De Vido closed the meeting emphasizing that this legal action against AES was a stand-alone case that did not in any way reflect a GoA bias against U.S. companies or investment. "This is not a problem with the United States, but rather with a U.S. company," he said, noting that he'd met for two hours earlier that day with senior Exxon executives talking about new investments and had held recent discussions with GE (to discuss bio-ethanol turbine opportunities) and Boeing (to explore 737-700 aircraft sales or leases to flag carrier Aerolineas Argentinas). He also noted Apache Energy's participation in his Ministry's Gas Plus program and Occidental Petroleum's likely participation in the recently announced Petroleum Plus initiative. Finally, De Vido noted that his earlier planned travel to the United States in November to promote off-shore drilling opportunities in joint ventures with national oil company ENARSA had been postponed due to the financial crisis, but that he hoped to re-schedule his travel for February/March.

Comment: Tax Evasion or Tax Avoidance?

¶12. (C) The Planning Ministry's orchestrated campaign to demonize AES, in three consecutive official news agency cables, comes in the immediate aftermath of four days of heat wave induced rolling power outages in the Greater Buenos Aries metropolitan area and in La Plata. The outages, including by an AES subsidiary, reflect a pattern of under-investment in Argentine electricity distribution infrastructure by privately owned utilities that has largely been forced by GoA policies holding domestic electricity tariffs well below comparable tariffs levels in the region (e.g., Brazil and Chile). AES insists that current tariffs permitted by the GoA fall well below levels required to earn a return on investment adequate to fund capital investment, debt payments, and reasonable dividends to shareholders. The blackouts are said to have personally embarrassed Minister de Vido, who had recently announced that GoA investment ensured adequate electricity supplies for the upcoming summer peak

season.

¶13. (C) As to the validity of GoA charges that AES has knowingly decapitalized its Edelap subsidiary, we will learn more following AES U.S. management discussions with De Vido. Energy sector analysts here agree that the line between legal tax minimization strategies, including the use of tax-advantaged Uruguayan holding companies, and illegal tax evasion is a fine one in Argentina. One of the GoA's key concerns appears to be that AES purchased its own debt from creditor banks at a substantial discount but booked it at face value. Yet the GoA has had little compunction about repurchasing its own sovereign debt, which is currently trading at default level discounts of up to 60% of face value.

¶14. (C) The GoA's move against AES is seen by some analysts here as one of a growing number of GoA efforts to ensure that strategic national assets remain in -- or are returned to -- government-friendly Argentine hands. Recent examples include the GoA's state-owned bank financing of a debt re-financing package for Coto Supermarket in the face of a foreign buy-out offer; the Venezuela-financed rescue package of Argentina's emblematic San Cor Dairy Cooperative in the face of a U.S. (Soros Group) buy-out proposal; the GoA's support for the local Peterson group's purchase of a 15% stake in Spanish-owned Argentine energy giant Repsol-YPF; the above mentioned Electro-Ingeneria displacement of U.S. investment

fund Eton Park in electricity transmission monopoly Transener; and current efforts to nationalize/expropriate flag carrier Aerolineas Argentinas. Such economic nationalism plays well with the Kirchner administration's populist base, but is not exactly music to the ears of current and prospective foreign investors.
KELLY